

NIXON PEABODY^{LLP}
ATTORNEYS AT LAW

TO: David Vandivier, Department of Treasury

FROM: Richard S. Goldstein

DATE: April 15, 2009

RE: LIHTC "Exchange" Program

This Memorandum follows up our discussion from earlier today with you and your colleagues concerning the ability to exchange certain low-income housing tax credits. Thank you for taking time from your busy schedule to discuss these questions.

Section 1602 of the recently enacted American Recovery and Reinvestment Act of 2009 (P.L.111-5) ("ARRA") established a temporary program (the "Exchange Program") whereby State housing credit agencies may exchange a portion of their 2009 housing credit ceiling under Section 42(h)(3)(C) of the Internal Revenue Code of 1986, as amended (the "Code") for grants with which the housing credit agency may make subawards to finance the development of qualified low-income buildings. A question has arisen as to whether low-income housing credits which are authorized under Section 1400N(c) of the Code, including credits authorized pursuant to the Gulf Opportunity Zone Act of 2005 (the "GO Zone Act"), the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Division C of Public Law 110-343) (the "Act") for the Midwestern disaster area, as defined in Section 702(b) of the Act and the Hurricane Ike disaster area as defined in Section 704(b) of the Act (collectively, "Disaster Relief Credits"), are subject to being exchanged under the Exchange Program as set forth in Section 1602 of ARRA.

It is our belief, for the reasons set forth below, that a portion of Disaster Relief Credits may be exchanged. The amount exchangeable is equal to the amount of such credits previously allocated by a State housing credit agency prior to 2009 and returned to the State in 2009 under the circumstances described in the flush language at the end of Section 42(h)(3)(C) of the Code and in Treasury Regulation Section 1.42-14(d). We request that the Treasury provide guidance as soon as possible that such previously allocated Disaster Relief Credits which are returned in 2009 are subject to the Exchange Program.

Discussion

Section 1602. Section 1602 of ARRA provides that the Treasury shall make a grant to a State housing credit agency in an amount equal to the State's "low-income housing grant election amount" which is determined, in part, by calculating the sum of (i) 100 percent of the State's housing credit ceiling for 2009 which is attributable amounts described in clauses (i) and (iii) of Code Section 42(h)(3)(C) and (ii) 40 of the State's housing credit ceiling for 2009 which is attributable to amounts described in clauses (ii) and (iv) of such section. Clauses (i) through (iv) of Section 42(h)(3)(C) are the various components which comprise the State's housing credit ceiling. Clause (i) describes the unused State housing credit ceiling of such State for the preceding calendar year, clause (ii) describes the population based component of the housing credit ceiling, clause (iii) describes the amount of low-income housing credit returned during the calendar year and clause (iv) describes the amount re-allocated to the State by the Secretary of Treasury under the so-called "national pool". Section 1602 made no specific mention of low-income housing credits that are authorized under the provisions of Section 1400N(c), which provides Disaster Relief Credits to the Gulf Opportunity Zone and the Midwestern disaster area and Hurricane Ike disaster area. However, as noted above, one of the components of the State's housing credit ceiling is comprised of previously allocated credits which are returned to the State housing credit agency. There is no statutory authority or legislative history that suggests that previously allocated Disaster Relief Credits may not be returned to the State housing credit agency in the same manner as other previously allocated low-income housing tax credits.

Returned Credits. The flush language at the end of Code Section 42(h)(3)(C) describes the amount of returned credits in a calendar year as the housing credit dollar amount previously allocated within the State to (i) any project which fails to timely meet the ten percent expenditure test for carryover allocations, or (ii) which fails to become a qualified low-income housing project within the timeframes set forth in Section 42 or the terms of the allocation or (iii) any project with respect to which the allocation is cancelled by mutual consent of the housing credit agency and recipient. Such returned credits—which, as noted above, are the amount described in clause (iii) of Section 42(h)(3)(C)--thereafter become a part of the housing credit ceiling available for allocation in the year the housing credits are returned. Treasury Regulation Section 1.42-14(d) goes on to state that a returned credit must have been allocated in a prior calendar year in order to qualify and it provides other helpful guidance. Nothing in Section 42 or in Treasury Regulation Section 1.42-14 prohibits the return of Disaster Relief Credits.

Gulf Opportunity Zone Act of 2005. After the occurrence of Hurricane Katrina, Congress enacted the GO Zone Act. The GO Zone Act added Code Section 1400N, which, among other things, provided additional low-income housing tax credits (“GO Zone Credits”) to the “GO Zone” as described in the GO Zone Act, for calendar years 2006, 2007 and 2008. The legislative history issued by the Joint Committee on Taxation in connection with the passage of the GO Zone Act states that the additional GO Zone Credits that are not allocated in any year may not be carried forward from that year to any other year (See, Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of H.R. 4440, the “Gulf Opportunity Zone Act of 2005”, as Passed by the House of Representatives and Senate*, (“JCX-88-05”), December 16, 2005, at p. 12). However, the Joint Committee Report goes on to support the view that GO Zone Credits may be returned in order to be re-allocated. Under the heading “Stacking rule,” the Joint Committee states that each State in the GO Zone is treated as using credits in a certain order: the first credits used are generated from the additional credit cap (i.e., the additional GO Zone Credits) “(including any such credits returned to the State).” JCX 88-05 at p. 12 [Emphasis added]. Accordingly, although GO Zone Credits that are not allocated in any year may not be carried forward, the legislative history makes a clear differentiation with respect to returned credits, stating explicitly that the first credits used in any year includes GO Zone credits that are returned. The definition of returned credits, as set forth above, includes only credits that were previously allocated, making such credits very different from credits that were never allocated and cannot therefore be carried forward.

Disaster Relief Credits. The low-income housing tax credits that were authorized for the Midwest disaster area and Hurricane Ike disaster area follow the same legislative path as the GO Zone Credits. Indeed, Section 702(d)(2) of the Act provides that Section 1400N(c) (the Section which provided GO Zone Credits) will be applied, with certain modifications not relevant here, to the Midwestern disaster area for calendar years 2008, 2009 and 2010. Section 704(b) of the Act provides that Section 1400N(c) will be applied, with certain modifications not relevant here, to the Hurricane Ike disaster area for calendar years 2008, 2009 and 2010. Unlike the GO Zone Credits, new allocations of Midwest disaster credits and Hurricane Ike disaster credits may still be made until the end of 2010. Pursuant to that authority, States within the Midwestern and Hurricane Ike disaster areas have made their respective allocations of the additional credits to certain projects in 2008. Due to the lack of sufficient investment dollars that has resulted from the economic recession and credit crisis, many such projects have been unable to proceed. Owners of some of these projects have discussed with their housing credit agencies the possibility of returning these credits pursuant to a mutual consent agreement

with the agency with the hope that these returned credits could then be exchanged pursuant to the ARRA Exchange Program.

Guidance Sought. Because of the uncertainty surrounding whether such credits are subject to the Exchange Program, guidance is being sought that would make clear that Disaster Relief Credits, including those for the Midwest and Hurricane Ike disaster areas well as GO Zone Credits, that were allocated prior to 2009 and are returned in 2009 may be included in a State's 2009 housing credit ceiling as returned credits for purposes of Section 42(h)(3)(C)(iii) and then exchanged pursuant to the Exchange Program. Even if the Treasury were to determine that GO Zone Credits allocated prior to 2009 may not be returned and re-allocated in 2009, that determination should not prevent the issuance of guidance that Midwest and Hurricane Ike disaster credits allocated prior to 2009 may be returned and may be subject to exchange pursuant to the Exchange Program.

I appreciate your consideration of the views set forth in this Memorandum.

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To ensure compliance with IRS requirements, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.